

Introduced by Senator Poochigian

February 22, 2005

An act to amend Sections 16328, 16335, 16336, and 16338, and to add Sections 16336.4, 16336.5, 16336.6, and 16336.7 to, the Probate Code, relating to trusts.

LEGISLATIVE COUNSEL'S DIGEST

SB 754, as introduced, Poochigian. Unitrust conversions.

Existing law governs proceedings for the administration of trusts.

This bill would authorize a trustee, unless prohibited by the governing instrument, to convert a trust into a unitrust, pursuant to specified procedures. The bill would permit the trustee to convert a trust into a unitrust without a court order if specified conditions and requirements are satisfied, the trustee gives written notice of the intent to convert in accordance with certain notice requirements, there is at least one legally competent beneficiary currently eligible to receive income from the trust, there is at least one competent beneficiary who would receive, if no powers of appointment were exercised, a distribution of principal if the trust were to terminate, and no legally competent beneficiary objects to the proposed action in writing during a specified timeframe. The bill would give the trustee the power, after a trust is converted to a unitrust, to make regular distributions of trust income in accordance with specified provisions. The bill would also establish procedures by which a trustee may reconvert from a unitrust to a trust and change the distribution payout percentage of a unitrust. The bill would require a fiduciary administering a unitrust, reconverting a unitrust, or changing the percentage payout from a unitrust to administer the trust impartially. The bill would make other conforming changes to related provisions of law related to trust administration.

Vote: majority. Appropriation: no. Fiscal committee: no.
State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 16328 of the Probate Code is amended
2 to read:

3 16328. “Net income” means the total receipts allocated to
4 income during an accounting period minus the disbursements
5 made from income during the accounting period, plus or minus
6 transfers under this chapter to or from income during the
7 accounting period. *During any period when the trust is being*
8 *administered as a unitrust, either pursuant to the powers*
9 *conferred by Sections 16336.4 to 16336.6, inclusive, or pursuant*
10 *to the terms of the governing instrument, “net income” means the*
11 *unitrust amount, if the unitrust amount is no less than 3 percent*
12 *and no more than 5 percent of the fair market value of the trust*
13 *assets, whether determined annually or averaged on a multiple*
14 *year basis.*

15 SEC. 2. Section 16335 of the Probate Code is amended to
16 read:

17 16335. (a) In allocating receipts and disbursements to or
18 between principal and income, and with respect to any other
19 matter within the scope of this chapter, a fiduciary:

20 (1) Shall administer a trust or decedent’s estate in accordance
21 with the trust or the will, even if there is a different provision in
22 this chapter.

23 (2) May administer a trust or decedent’s estate by the exercise
24 of a discretionary power of administration given to the fiduciary
25 by the trust or the will, even if the exercise of the power produces
26 a result different from a result required or permitted by this
27 chapter, and no inference that the fiduciary has improperly
28 exercised the discretion arises from the fact that the fiduciary has
29 made an allocation contrary to a provision of this chapter.

30 (3) Shall administer a trust or decedent’s estate in accordance
31 with this chapter if the trust or the will does not contain a
32 different provision or does not give the fiduciary a discretionary
33 power of administration.

34 (4) Shall add a receipt or charge a disbursement to principal to
35 the extent that the trust or the will and this chapter do not provide

1 a rule for allocating the receipt or disbursement to or between
2 principal and income.

3 (b) In exercising a discretionary power of administration
4 regarding a matter within the scope of this chapter, whether
5 granted by a trust, a will, or this chapter, including the trustee's
6 power to adjust under subdivision (a) of Section 16336 *and the*
7 *trustee's power to convert into a unitrust or reconvert or change*
8 *the unitrust payout percentage pursuant to Sections 16336.4 to*
9 *16336.6, inclusive*, the fiduciary shall administer the trust or
10 decedent's estate impartially, except to the extent that the trust or
11 the will expresses an intention that the fiduciary shall or may
12 favor one or more of the beneficiaries. The exercise of discretion
13 in accordance with this chapter is presumed to be fair and
14 reasonable to all beneficiaries.

15 SEC. 3. Section 16336 of the Probate Code is amended to
16 read:

17 16336. (a) Subject to subdivision (b), a trustee may make an
18 adjustment between principal and income to the extent the trustee
19 considers necessary if all of the following conditions are
20 satisfied:

21 (1) The trustee invests and manages trust assets under the
22 prudent investor rule.

23 (2) The trust describes the amount that shall or may be
24 distributed to a beneficiary by referring to the trust's income.

25 (3) The trustee determines, after applying the rules in
26 subdivision (a) of Section 16335, and considering any power the
27 trustee may have under the trust to invade principal or
28 accumulate income, that the trustee is unable to comply with
29 subdivision (b) of Section 16335.

30 (b) A trustee may not make an adjustment between principal
31 and income in any of the following circumstances:

32 (1) Where it would diminish the income interest in a trust (A)
33 that requires all of the income to be paid at least annually to a
34 spouse and (B) for which, if the trustee did not have the power to
35 make the adjustment, an estate tax or gift tax marital deduction
36 would be allowed, in whole or in part.

37 (2) Where it would reduce the actuarial value of the income
38 interest in a trust to which a person transfers property with the
39 intent to qualify for a gift tax exclusion.

1 (3) Where it would change the amount payable to a
2 beneficiary as a fixed annuity or a fixed fraction of the value of
3 the trust assets.

4 (4) Where it would be made from any amount that is
5 permanently set aside for charitable purposes under a will or
6 trust, unless both income and principal are so set aside.

7 (5) Where possessing or exercising the power to make an
8 adjustment would cause an individual to be treated as the owner
9 of all or part of the trust for income tax purposes, and the
10 individual would not be treated as the owner if the trustee did not
11 possess the power to make an adjustment.

12 (6) Where possessing or exercising the power to make an
13 adjustment would cause all or part of the trust assets to be
14 included for estate tax purposes in the estate of an individual who
15 has the power to remove a trustee or appoint a trustee, or both,
16 and the assets would not be included in the estate of the
17 individual if the trustee did not possess the power to make an
18 adjustment.

19 (7) Where the trustee is a beneficiary of the trust.

20 (8) *During any period when the trust is being administered as*
21 *a unitrust pursuant to the trustee's exercise of the power to*
22 *convert provided in Section 16336.4 or 16336.5.*

23 (c) Notwithstanding Section 15620, if paragraph (5), (6), or (7)
24 of subdivision (b) applies to a trustee and there is more than one
25 trustee, a cotrustee to whom the provision does not apply may
26 make the adjustment unless the exercise of the power by the
27 remaining trustee or trustees is not permitted by the trust.

28 (d) A trustee may release the entire power conferred by
29 subdivision (a) or may release only the power to adjust from
30 income to principal or the power to adjust from principal to
31 income in either of the following circumstances:

32 (1) If the trustee is uncertain about whether possessing or
33 exercising the power will cause a result described in paragraphs
34 (1) to (6), inclusive, of subdivision (b).

35 (2) If the trustee determines that possessing or exercising the
36 power will or may deprive the trust of a tax benefit or impose a
37 tax burden not described in subdivision (b).

38 (e) A release under subdivision (d) may be permanent or for a
39 specified period, including a period measured by the life of an
40 individual.

1 (f) A trust that limits the power of a trustee to make an
2 adjustment between principal and income does not affect the
3 application of this section unless it is clear from the trust that it is
4 intended to deny the trustee the power of adjustment provided by
5 subdivision (a).

6 (g) In deciding whether and to what extent to exercise the
7 power to make adjustments under this section, the trustee may
8 consider, but is not limited to, any of the following:

9 (1) The nature, purpose, and expected duration of the trust.

10 (2) The intent of the settlor.

11 (3) The identity and circumstances of the beneficiaries.

12 (4) The needs for liquidity, regularity of income, and
13 preservation and appreciation of capital.

14 (5) The assets held in the trust; the extent to which they consist
15 of financial assets, interests in closely held enterprises, tangible
16 and intangible personal property, or real property; the extent to
17 which an asset is used by a beneficiary; and whether an asset was
18 purchased by the trustee or received from the settlor.

19 (6) The net amount allocated to income under other statutes
20 and the increase or decrease in the value of the principal assets,
21 which the trustee may estimate as to assets for which market
22 values are not readily available.

23 (7) Whether and to what extent the trust gives the trustee the
24 power to invade principal or accumulate income or prohibit the
25 trustee from invading principal or accumulating income, and the
26 extent to which the trustee has exercised a power from time to
27 time to invade principal or accumulate income.

28 (8) The actual and anticipated effect of economic conditions
29 on principal and income and effects of inflation and deflation.

30 (9) The anticipated tax consequences of an adjustment.

31 (h) Nothing in this section or in this chapter is intended to
32 create or imply a duty to make an adjustment, and a trustee is not
33 liable for not considering whether to make an adjustment or for
34 choosing not to make an adjustment.

35 SEC. 4. Section 16336.4 is added to the Probate Code, to
36 read:

37 16336.4. (a) Unless expressly prohibited by the governing
38 instrument, a trustee may convert a trust into a unitrust, as
39 described in this section. A trust that limits the power of the
40 trustee to make an adjustment between principal and income or

1 modify the trust does not affect the application of this section
2 unless it is clear from the governing instrument that it is intended
3 to deny the trustee the power to convert into a unitrust.

4 (b) The trustee may convert a trust into a unitrust without a
5 court order if all of the following apply:

6 (1) The conditions set forth in subdivision (a) of Section
7 16336 are satisfied.

8 (2) The unitrust proposed by the trustee conforms to the
9 provisions of subdivision (e).

10 (3) The trustee gives written notice of the trustee's intention to
11 convert the trust into a unitrust and furnishes the information
12 required by subdivision (c). The notice shall comply with the
13 requirements of Chapter 5 (commencing with Section 16500).

14 (4) There is at least one legally competent beneficiary who is
15 currently eligible to receive income from the trust.

16 (5) There is at least one legally competent beneficiary who
17 would receive, if no powers of appointment were exercised, a
18 distribution of principal if the trust were to terminate
19 immediately prior to the giving of notice.

20 (6) No legally competent beneficiary objects to the proposed
21 action in a writing delivered to the trustee within the period
22 prescribed by subdivision (d) of Section 16502 or a longer period
23 as is specified in the notice described in subdivision (c).

24 (c) The notice described in paragraph (3) of subdivision (b)
25 shall include a copy of Sections 16336.4 to 16336.7, inclusive,
26 and all of the following additional information:

27 (1) A statement that the trust shall be administered in
28 accordance with the provisions of subdivision (e) and the
29 effective date of the conversion.

30 (2) A description of the method to be used for determining the
31 fair market value of trust assets.

32 (3) The amount actually distributed to the income beneficiary
33 during the previous accounting year of the trust.

34 (4) The amount that would have been distributed to the income
35 beneficiary during the previous accounting year of the trust had
36 the trustee's proposed changes been in effect during that entire
37 year.

38 (5) A description of the discretionary decisions the trustee
39 proposes to make as of the conversion date pursuant to
40 subdivision (f).

1 (d) In deciding whether to exercise the power conferred by this
2 section, a trustee may consider, among other things, the factors
3 set forth in subdivision (g) of Section 16336.

4 (e) Except to the extent that the court orders otherwise or the
5 parties agree otherwise pursuant to Section 16336.5 after a trust
6 is converted to a unitrust, all of the following shall apply:

7 (1) The trustee shall make regular distributions in accordance
8 with the governing instrument construed in accordance with the
9 provisions of this section.

10 (2) The term “income” in the governing instrument shall mean
11 an annual distribution, the unitrust amount, equal to 4 percent,
12 which is the payout percentage, of the net fair market value of the
13 trust’s assets, whether those assets would be considered income
14 or principal under other provisions of this chapter, averaged over
15 the lesser of: (A) the three preceding years, or (B) the period
16 during which the trust has been in existence.

17 (3) During each accounting year of the trust following its
18 conversion into a unitrust, the trustee shall, as early in the year as
19 is practicable, furnish each income beneficiary with a statement
20 describing the computation of the unitrust amount for that
21 accounting year.

22 (4) The trustee shall determine the net fair market value of
23 each asset held in the trust no less often than annually. However,
24 the following property shall not be included in determining the
25 unitrust amount:

26 (A) Any residential property or any tangible personal property
27 that, as of the first business day of the current accounting year,
28 one or more current beneficiaries of the trust have or have had
29 the right to occupy, or have or have had the right to possess or
30 control, other than in his or her capacity as trustee of the trust,
31 which property shall be administered according to other
32 provisions of this chapter as though no conversion to a unitrust
33 had occurred.

34 (B) Any asset specifically devised to a beneficiary to the
35 extent necessary, in the trustee’s reasonable judgment, to avoid a
36 material risk of exhausting other trust assets prior to termination
37 of the trust. All net income generated by a specifically devised
38 asset excluded from the unitrust computation pursuant to this
39 subdivision shall be accumulated or distributed by the trustee

1 according to the rules otherwise applicable to that net income
2 pursuant to other provisions of this chapter.

3 (C) Any asset while held in a testator's estate or a terminating
4 trust.

5 (5) The unitrust amount, as otherwise computed pursuant to
6 this subdivision, shall be reduced proportionately for any
7 material distribution made to accomplish a partial termination of
8 the trust required by the governing instrument or made as a result
9 of the exercise of a power of appointment or withdrawal, other
10 than distributions of the unitrust amount, and shall be increased
11 proportionately for the receipt of any material addition to the
12 trust, other than a receipt that represents a return on investment,
13 during the period considered in paragraph (2) in computing the
14 unitrust amount. For the purpose of this paragraph, a distribution
15 or an addition shall be "material" if the net value of the
16 distribution or addition, when combined with all prior
17 distributions made or additions received during the same
18 accounting year, exceeds 10 percent of the value of the assets
19 used to compute the unitrust amount as of the most recent prior
20 valuation date. The trustee may, in the reasonable exercise of his
21 or her discretion, adjust the unitrust amount pursuant to this
22 subdivision even if the distributions or additions are not
23 sufficient to meet the definition of materiality set forth in the
24 preceding sentence.

25 (6) In the case of a short year in which a beneficiary's right to
26 payments commences or ceases, the trustee shall prorate the
27 unitrust amount on a daily basis.

28 (7) Unless otherwise provided by the governing instrument or
29 determined by the trustee, the unitrust amount shall be
30 considered paid in the following order from the following
31 sources:

32 (A) From the net taxable income, determined as if the trust
33 were other than a unitrust.

34 (B) From net realized short-term capital gains.

35 (C) From net realized long-term capital gains.

36 (D) From tax-exempt and other income.

37 (E) From principal of the trust.

38 (8) Expenses that would be deducted from income if the trust
39 were not a unitrust may not be deducted from the unitrust
40 amount.

1 (f) The trustee shall determine, in the trustee's discretion, all
2 of the following matters relating to administration of a unitrust
3 created pursuant to this section:

4 (1) The effective date of a conversion to a unitrust.

5 (2) The frequency of payments in satisfaction of the unitrust
6 amount.

7 (3) Whether to value the trust's assets annually or more
8 frequently.

9 (4) What valuation dates to use.

10 (5) How to value nonliquid assets.

11 (6) The characterization of the unitrust payout for income tax
12 reporting purposes. However, the trustee's characterization shall
13 be consistent from time to time.

14 (7) Any other matters necessary for the proper functioning of
15 the unitrust.

16 (g) A conversion into a unitrust does not affect a provision in
17 the governing instrument directing or authorizing the trustee to
18 distribute principal or authorizing the exercise of a power of
19 appointment over or withdrawal of all or a portion of the
20 principal.

21 (h) A trustee may not convert a trust into a unitrust in any of
22 the following circumstances:

23 (1) If payment of the unitrust amount would change the
24 amount payable to a beneficiary as a fixed annuity or a fixed
25 fraction of the value of the trust assets.

26 (2) If the unitrust distribution would be made from any amount
27 that is permanently set aside for charitable purposes under the
28 governing instrument and for which a federal estate or gift tax
29 deduction has been taken, unless both income and principal are
30 set aside.

31 (3) If possessing or exercising the power to convert would
32 cause an individual to be treated as the owner of all or part of the
33 trust for federal income tax purposes, and the individual would
34 not be treated as the owner if the trustee did not possess the
35 power to convert.

36 (4) If possessing or exercising the power to convert would
37 cause all or part of the trust assets to be subject to federal estate
38 or gift tax with respect to an individual, and the assets would not
39 be subject to federal estate or gift tax with respect to the
40 individual if the trustee did not possess the power to convert.

1 (5) If the conversion would result in the disallowance of a
2 federal estate tax or gift tax marital deduction that would be
3 allowed if the trustee did not have the power to convert.

4 (i) If paragraph (3) or (4) of subdivision (h) applies to a trustee
5 and there is more than one trustee, a co trustee to whom the
6 provision does not apply may convert the trust unless the
7 exercise of the power by the remaining trustee or trustees is
8 prohibited by the governing instrument. If paragraph (3) or (4) of
9 subdivision (h) applies to all of the trustees, the court may order
10 the conversion as provided in subdivision (b) of Section 16336.5.

11 (j) A trustee may release the power conferred by this section to
12 convert to a unitrust if (1) the trustee is uncertain about whether
13 possessing or exercising the power will cause a result described
14 in paragraph (3), (4), or (5) of subdivision (h), or (2) the trustee
15 determines that possessing or exercising the power will or may
16 deprive the trust of a tax benefit or impose a tax burden not
17 described in subdivision (h). The release may be permanent or
18 for a specified period, including a period measured by the life of
19 an individual.

20 SEC. 5. Section 16336.5 is added to the Probate Code, to
21 read:

22 16336.5. (a) The trustee may convert a trust into a unitrust
23 upon terms other than those set forth in subdivision (e) of Section
24 16336.4, without court order, if all of the following apply:

25 (1) The conditions set forth in subdivision (a) of Section
26 16336 are satisfied.

27 (2) The trustee gives written notice of the trustee's intention to
28 convert the trust into a unitrust and furnishes the information
29 required by subdivision (c) of Section 16336.4. The notice shall
30 comply with the requirements of Chapter 5 (commencing with
31 Section 16500).

32 (3) The payout percentage to be adopted is at least 3 percent
33 and no greater than 5 percent.

34 (4) There is at least one legally competent beneficiary who is
35 currently eligible to receive income from the trust.

36 (5) There is at least one legally competent beneficiary who
37 would receive, if no powers of appointment were exercised, a
38 distribution of principal if the trust were to terminate
39 immediately prior to the giving of notice.

1 (6) All legally competent beneficiaries entitled to notice under
2 Section 16501 consent in writing to the proposed action after
3 having been furnished with the notice described in subdivision
4 (c) of Section 16336.4.

5 (b) The court may order the conversion of a trust into a
6 unitrust as provided in this subdivision.

7 (1) (A) The trustee may petition the court to approve the
8 conversion to a unitrust for any one of the following reasons:

9 (i) A beneficiary timely objects to a proposed conversion to a
10 unitrust.

11 (ii) The trustee proposes to make the conversion upon terms
12 other than those described in subdivision (e) of Section 16336.4.

13 (iii) Paragraph (3) or (4) of subdivision (h) of Section 16336.4
14 applies to all currently acting trustees.

15 (iv) For any other reason other than those set forth in
16 subparagraphs (A) to (C), inclusive, the trustee determines, in its
17 discretion, that a petition is advisable.

18 (B) In no event, however, may the court authorize conversion
19 to a unitrust with a payout percentage of less than 3 percent or
20 greater than 5 percent of the fair market value of the trust assets.

21 (2) A beneficiary may petition the court to order the
22 conversion.

23 (3) The court shall approve the conversion proposed by the
24 trustee or direct the conversion requested by the beneficiary if the
25 conditions set forth in subdivision (a) of Section 16336 are
26 satisfied and the court concludes that conversion of the trust on
27 the terms proposed will enable the trustee to better comply with
28 the provisions of subdivision (b) of Section 16335.

29 (4) In deciding whether to approve a proposed conversion or
30 direct a requested conversion, the court may consider, among
31 other factors, those described in subdivision (g) of Section
32 16336.

33 SEC. 6. Section 16336.6 is added to the Probate Code, to
34 read:

35 16336.6. Unless expressly prohibited by the governing
36 instrument, a trustee may reconvert the trust from a unitrust or
37 change the payout percentage of a unitrust.

38 (a) The trustee may make the reconversion or change in
39 payout percentage without a court order if all of the following
40 conditions are satisfied:

1 (1) At least five years have elapsed since the most recent
2 conversion to a unitrust.

3 (2) The trustee determines that reconversion or change in
4 payout percentage would enable the trustee to better comply with
5 the provisions of subdivision (b) of Section 16335.

6 (3) In the case of a proposed reconversion, the conditions set
7 forth in paragraphs (4) to (6), inclusive, of subdivision (b) of
8 Section 16336.4 have been satisfied and the trustee gives written
9 notice of the trustee's intention to reconvert the trust. The notice
10 shall comply with the requirements of Chapter 5 (commencing
11 with Section 16500).

12 (4) In the case of a proposed change in payout percentage, the
13 conditions set forth in paragraphs (3) to (6), inclusive, of
14 subdivision (a) of Section 16336.5 have been satisfied and the
15 trustee gives written notice stating the new payout percentage
16 that the trustee proposes to adopt. The notice shall comply with
17 the requirements of Chapter 5 (commencing with Section 16500).

18 (b) The trustee may make the reconversion or change in
19 payout percentage at any time pursuant to court order provided
20 that: (1) the court determines that reconversion or change in
21 payout percentage will enable the trustee to better comply with
22 the provisions of subdivision (b) of Section 16335, and (2) in the
23 case of a change in payout percentage, the new payout
24 percentage is at least 3 percent and no greater than 5 percent. The
25 court may enter an order pursuant to this subdivision upon the
26 petition of the trustee or any beneficiary.

27 SEC. 7. Section 16336.7 is added to the Probate Code, to
28 read:

29 16336.7. (a) Sections 16336.4 to 16336.6, inclusive, shall not
30 impose any duty on the trustee to convert or reconvert a trust or
31 to consider a conversion or reconversion.

32 (b) Subdivision (b) of Section 16503 applies to all actions
33 pursuant to Sections 16336.4 to 16336.6, inclusive, for which
34 notice of proposed action is given in compliance with Chapter 5
35 (commencing with Section 16500). However, a trustee shall not
36 be liable to any beneficiary entitled to notice who is not legally
37 competent at the time notice is given if (1) notice has been given
38 to another beneficiary who is legally competent and has a
39 substantially identical interest and no conflicting interest and (2)
40 that beneficiary has either given written consent, either before or

1 after the action is taken, or fails to make timely objection to the
2 proposed action.

3 (c) For purposes of this chapter, “legally competent,” when
4 describing a beneficiary, shall include both of the following:

5 (1) A beneficiary who is not a minor and who has the capacity
6 to object to the proposed action.

7 (2) A beneficiary who is a minor or who lacks capacity to
8 object to the proposed action but whose interests with respect to
9 the proposed action are represented by a guardian, conservator,
10 or other legal representative.

11 SEC. 8. Section 16338 of the Probate Code is amended to
12 read:

13 16338. In a proceeding with respect to a trustee’s exercise or
14 nonexercise of the power to make an adjustment under Section
15 16336, the sole remedy is to direct, deny, or revise an adjustment
16 between principal and income. *In a proceeding with respect to a*
17 *trustee’s exercise or nonexercise of a power conferred by*
18 *Sections 16336.4 to 16336.6, inclusive, the sole remedy is to*
19 *obtain an order directing the trustee to convert the trust to a*
20 *unitrust, to reconvert from a unitrust, to change the distribution*
21 *percentage, or to order any administrative procedures the court*
22 *determines to be necessary or helpful for the proper functioning*
23 *of the trust.*